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April 15, 2013

TO: **HOUSE WAYS & MEANS COMMITTEE,**

TAX REFORM WORKING GROUP (ENERGY)

FROM: **CLEAN ENERGY FUELS CORP.**

SUBJECT: **ISSUE RELATED TO NATURAL GAS FOR TRANSPORTATION, SUBMISSIONS FOR CONSIDERATION BY THE COMMITTEE AS IT CONSIDERS REFORMING THE TAX CODE**

As the Ways & Means Committee, through its working groups, considers options for simplifying and reforming the tax code, it must recognize that its deliberations and conclusions have the potential to profoundly transform the way the U.S. identifies, develops and uses transportation fuel – away from traditional energy sources such as foreign oil, and toward domestic alternative fuels including natural gas.

Clean Energy, America's leading provider of natural gas for transportation, would like to help the Committee understand how current federal tax policies have unintentionally and unfairly hindered the natural gas industry from competing with diesel fuel on a proverbial "level playing field;" and how a few simple changes would remove barriers to expansion of natural gas as our leading transportation fuel in America. And we hope to point out why it would be the right and fair thing to do, in the best interests of the American people.

As active members of Natural Gas Vehicles America (NGVA), we endorse their submission on many of these same points. Due to NGVA's detailed submission, we will restrict our submission to highlighting one key issue that we believe logically and appropriately should be included within tax reform measures. We respectfully submit this for your consideration:

<u>FIXING THE LNG FEDERAL EXCISE TAX INEQUITY</u>

<u>Current Federal tax policy puts LNG at a disadvantage to diesel</u>

As currently applied, Federal tax policy provides a distinct advantage to users of diesel over the cleaner, cheaper and domestic alternative: natural gas. This is the case despite policymakers insisting that federal rules not "pick winners and losers." Here's how it works:

The federal highway excise tax on both diesel and Liquefied Natural Gas (LNG) is set at 24.3 cents per gallon (26 USC §§ 4041, 4081). However, LNG produces less energy *per gallon* than diesel fuel; it takes about 1.7 gallons of LNG to equal the same BTU content as one gallon of diesel fuel. As a result, since the excise tax is based on volume, not energy content, LNG is taxed at 170% of the rate of diesel on an energy equivalent basis. This equates to a diesel gallon equivalent rate of 41.3 cents for LNG – or 17 cents more than diesel is taxed. This disparity creates a significant disincentive for the use of LNG.

We feel certain that this was never intended. In fact, the way the federal highway excise tax is applied for LNG and its equivalent, diesel, is not at all the way it is applied for *compressed natural gas (CNG)* and its equivalent, gasoline. An energy equivalent basis is used for taxing CNG and gasoline, a much fairer approach that provides a nearly equal tax on both fuels.

As NGVA points out in its submission, the unfair application of taxes on LNG was not always the case: "The tax on LNG at one time was also was adjusted for its energy content. During the period 1997–2006, the LNG tax was tied to the gasoline rate of 18.3 cents but adjusted downward to 11.9 cents because of its lower energy content. SAFETEA-LU (P.L. 109-59), however, inexplicably modified the tax effective as of Oct. 1, 2006, basing the tax on the diesel rate and removing the adjustment for lower energy content."

Why, we don't know. What we do know is the current application is unfair, it negatively impacts those who use cleaner, domestic LNG, and it discourages conversion away from imported diesel to domestic natural gas. We also know that it is relatively easy to fix the situation; it is virtually, we submit, a technical fix – fixing a mistake that was made when the LNG tax was misapplied.

<u>The Federal Government is "picking winners and losers"</u>

In current law there are essentially two federal excise tax rates applied to transportation fuels:

- <u>18.4 cents/gallon for gasoline</u>
- <u>18.4 cents/gasoline gallon equivalent of Compressed Natural Gas (CNG)</u>. Where gasoline and CNG are predominantly used in light-duty and medium-duty vehicles
- <u>24.3 cents/gallon for diesel</u>
- <u>24.3 cents/gallon of Liquefied Natural Gas (LNG)</u>. Where diesel and LNG are predominately used in heavy-duty vehicles.

The intent of the law was to tax alternate fuels at equal levels relative to their gasoline and diesel counterparts. In doing so, it was supposed to create a level playing field for all types of transportation fuels, but it has unintentionally created a market disadvantage for LNG.

The LNG Formula is outdated and unfair

In terms of diesel, the metric for a comparison of taxing fuels was not made on an energy equivalent basis, but on a liquid gallon basis, which is an outdated metric relative to LNG. The metric used for CNG was the industry-recognized energy equivalent metric.

This puts LNG at a competitive disadvantage. On an energy equivalent basis, it takes 1.7 LNG gallons to provide the same energy as one diesel gallon. This translates to an effective tax rate of $0.413 per diesel equivalent gallon for LNG, a 70 percent higher tax than diesel, thus undermining the law's intent to create a level playing field.

There is a fair and simple solution

The clear inequity between the way diesel and LNG are taxed can be relatively easily solved by modernizing the formula to tax these fuels on an energy equivalent basis (Diesel Gallon Equivalent / DGE), not on a liquid LNG gallon.

This is the way that CNG was accurately measured against gasoline, and LNG should be measured against diesel. This provides a level playing field for the calculation of excise taxes on gasoline and CNG. Since this law was enacted in 2005, the Department of Energy, the California Air Resources Board (CARB) and many others use BTUs (British Thermal Units) to accurately compare fuels.

This proposed modernization of current law would treat LNG fairly relative to its diesel counterpart and provide a level playing field.

Market Effect

By our estimates LNG users are being penalized $3.4 million per year in excess taxes, based on 2011 consumption levels. This takes into account the fact that transit agencies, which use more than 50% of LNG sold today for transportation fuel, are exempt from this excise tax.

Equal taxation of LNG will open the door to private investment in LNG refueling infrastructure and production facilities which will provide local businesses access to a unique competitive advantage and communities with new construction jobs.

Thank you for your consideration. If the committee requires further information or has questions, please contact:

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